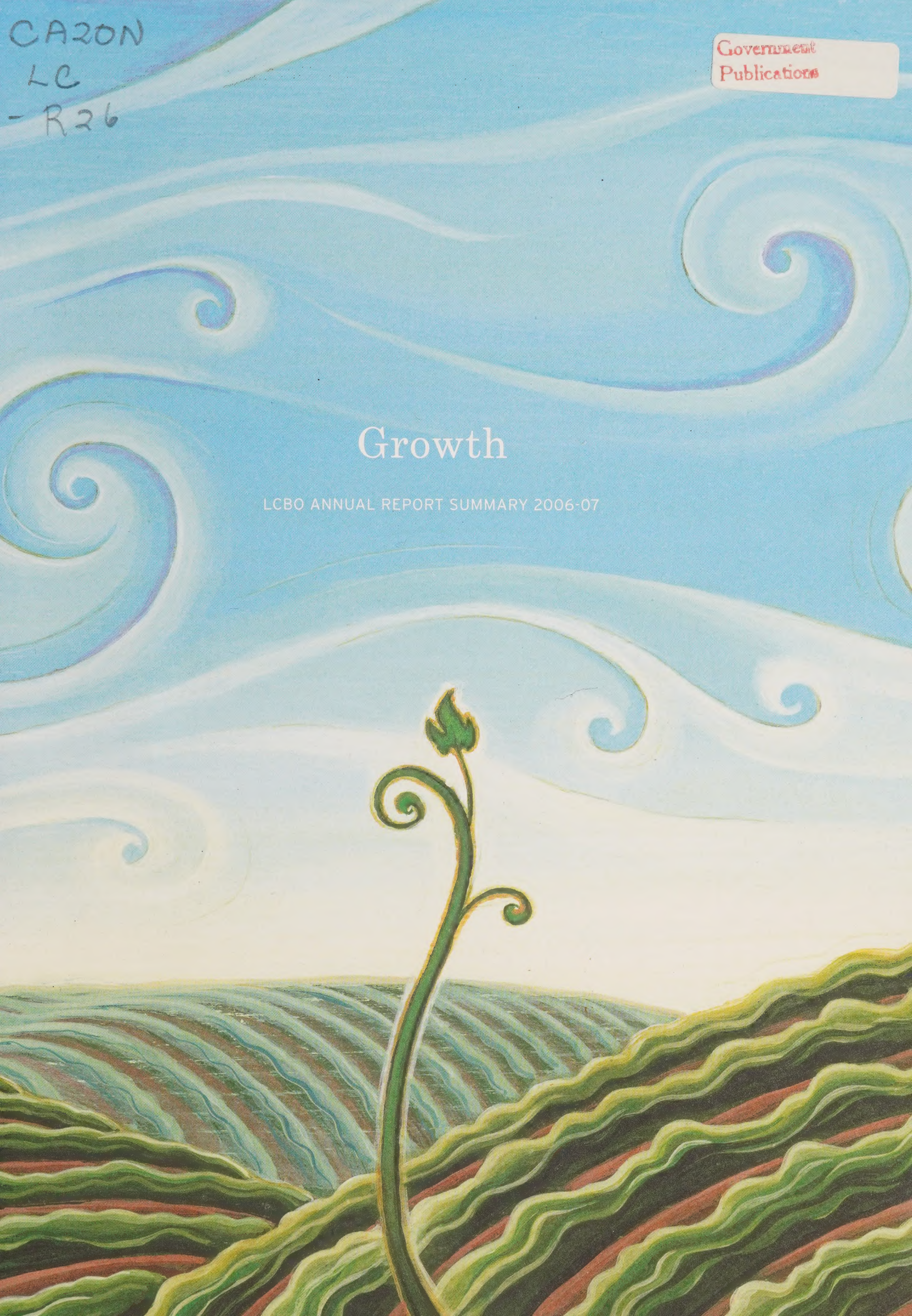
Growth

LCBO ANNUAL REPORT SUMMARY 2006-07



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Board Members

The LCBO achieved record growth in 2006-07 in sales, net income and annual dividend to Ontario taxpayers while supporting Ontario wines, craft beers and domestic spirits. There was also progress in keeping beverage alcohol out of the hands of those who should not have it, assuring product quality and safety, raising funds for worthy causes and helping protect our environment.

Philip J. Olsson *Chair*

It is an honour to be Chair of the LCBO and to have an opportunity to contribute to its further development. LCBO is an organization that takes pride in offering customer service in a socially responsible manner and that supports social programs and capital projects through its annual dividend.

The LCBO achieved record numbers in terms of its dividend to the government and net sales in 2006-07. These are impressive figures. They were produced through a high standard of fiscal management, operational efficiency, customer service excellence, effective merchandising and marketing and transparent corporate governance.

I became Acting Chair and CEO when former Chair and CEO Andy Brandt retired in February 2006. This year changes were made to the *Liquor Control Act*, which governs the operations of the LCBO. These changes were based on recommendations made by the LCBO after an extensive review of our governance practices. I became Chair, with Bob Peter becoming CEO (in addition to his duties as president), fully responsible for day-to-day operations and the management of the organization.

The separation of Chair and CEO roles provides a more modern governance structure and is consistent with best practices at other progressive private and public sector organizations. It strengthens the LCBO governance structure and increases the effectiveness of the highly professional management team.

Another amendment to the Act this year enabled the LCBO to increase membership of the Board from seven to 11, allowing the Board to draw on a more varied range of experience and expertise.

I look forward to leading the organization as the LCBO continues its successful evolution as a profitable, socially and environmentally responsible retailer that strives to constantly improve the customer shopping experience.

Philip J. Olsson
Chair
August 2007

Bob Peter *President and CEO*

Strong summer sales combined with record holiday sales of more than $500 million helped boost our financial performance. Demographics, appealing LCBO products and promotional activities also contributed to this record. Baby Boomers, with more disposable income than ever before, are trying new products, trading up to premium products and entertaining more.

We continued to improve our supply chain while also growing sales. As a result of these improvements, we've been able to further enhance product selection and availability while freeing up staff time to better serve customers and freeing up cash to reinvest in upgrading our stores, warehouses and IT systems. Our progress in improving our supply chain system was recognized by another award from the Retail Council of Canada in 2006-07 for our collaborative supplier online new product submission system.

The LCBO also built on its reputation as a socially responsible retailer by continuing to fundraise and support various charities at both the corporate and grassroots levels. We collected a new corporate record of $412,000 for the United Way, and for the second year in a row, LCBO was honoured with the United Way Spirit Award for Public Awareness.

We will continue to invest in our people and in our stores; the next fiscal year will see the opening of more stores, the relocation of others and the ongoing renovation of existing stores to update them to our current standards. All new stores will include bigger VINTAGES sections as well as increased Ontario wine and beer sections.

Our brand vision — *Discover the World* — has given us the direction and inspiration for what we have achieved since 2003 and it continues to be our road map. This vision works well and I am confident our employees will continue to deliver on this brand promise, providing our customers with the right products at the right time and serving them in a socially responsible manner.

Bob Peter

Bob Peter
President and Chief Executive Officer
August 2007

Committed to the Environment

LCBO's environmental strategy is contributing to a greener Ontario.

One of the ways the LCBO is reducing its eco-footprint is through innovative, lightweight and convenient alternative packaging such as Tetra Pak and PET (polyethylene terephthalate) plastic containers.

Sales of almost 200 such products topped $80 million in fiscal 2006-07, enabling the LCBO to meet its goal of eliminating 10 million kilograms of packaging waste per year two years ahead of schedule. Suppliers are also being encouraged to minimize packaging.

Other highlights:

→ The *Bag it Back* deposit return program, launched in February 2007, has recycled more than 100 million containers to higher end uses.

→ The LCBO continues to be a major financial contributor to the Blue Box program, with $5 million more provided this year and $35 million to date.

→ Energy and utility consumption at LCBO stores, offices and warehouses is being cut by 10 per cent per year.

→ More corrugated cardboard, fine paper, polystyrene, newspapers, batteries, printer cartridges, data tapes and other materials are being recycled.

→ The LCBO Natural Heritage Fund and suppliers raised almost $2 million to restore and rehabilitate native Ontario wildlife and habitat, including the return of Atlantic salmon to Lake Ontario.

Go to www.lcbo.com/AnnualReport for the full story.

Caring for the Community

Successful retailers today understand consumers are making buying decisions based on their values. The LCBO always strives to deliver programs and initiatives that reflect our customers' values.

Challenge and Refusals climb

Each year, Ontarians tell the LCBO that preventing sales to minors and intoxicated adults and promoting responsible drinking are what they expect most from our organization. This also ranked as the highest source of pride with staff when we conducted our most recent employee attitude survey. In fiscal 2006-07, our frontline employees challenged a record 1.8 million customers who appeared to be underage, intoxicated or were suspected of trying to buy beverage alcohol for a minor or intoxicated person – almost six per cent more than the previous year.

Charities receive $850,000 from LCBO fundraising

LCBO employees, customers and suppliers, raised more than $850,000 in 2006-07 to help others, including the United Way, Camp Oochigeas, MADD Canada, Friends of We Care, and other grassroots community-based initiatives.

Quality Assurance continues to assure products are safe to drink

Almost all products sold in LCBO stores must first be tasted, tested and certified by the LCBO's Quality Assurance (QA) laboratory. (VINTAGES tastes and approves the products it sells.) In fiscal 2006-07, the QA department conducted a record-high 434,333 tests on 18,519 products. As well, 5,004 products were tasted to ensure they met high standards set by the LCBO and, where applicable, the Vintners Quality Alliance Ontario (VQAO). QA staff also reviewed 3,910 labels and 9,648 shipping cartons.

Go to www.lcbo.com/AnnualReport for more details about the LCBO's Social Responsibility activities.


LCBO

Product Trends

Each of the four business units grew in 2006-07. The Wines business unit was up 7.5 per cent, reaching $1 billion in revenue for the first time; Spirits saw the most growth in its premium and deluxe price bands (up 6.7 per cent and 6.8 per cent respectively); Beer and Special Markets had net sales of $921.7 million versus the previous year's sales of $880.6 million; while VINTAGES sales jumped more than 18 per cent.

Wines

The LCBO introduced 256 new wines during 2006-07, accounting for $44 million in sales, or 61 per cent of revenue growth. The LCBO, supported by its suppliers, continued to implement its alternative container strategy. During 2006-07, we sold 90 products from nine countries, and from Ontario, packed in non-glass packages such as Tetra Pak containers, PET plastic bottles and aluminum cans. Consumer acceptance of these alternative containers surpassed expectations; during 2006-07, the LCBO sold products worth $25.5 million, or 2.5 per cent of total wine sales, in these formats.

Spirits

Spirits account for just 15 per cent of litre sales but 40 per cent of net sales and 47 per cent of margin dollars. The business unit's margin rate of 58.8 per cent was significantly higher than the corporate rate of 50.4 per cent and up from 58.1 per cent last year. Innovative spirits-specific promotions such as *Cocktail Remix*, *Whisky Generation* and *Just Add Liqueur*, helped spur this growth. Most growth in 2006-07 came in premium and deluxe price bands, up 6.7 per cent and 6.8 per cent respectively. Standard brands increased by 2.2 per cent in part due to floor price increases and changes to excise tax. Liqueurs grew by 7.3 per cent.

Beer and Special Markets

Beer and Special Markets finished the year ahead of plan with net sales of $921.7 million versus the previous year's sales of $880.6 million. As a result of a warm fall and early winter, Beer and Special Markets overall sales remained strong well after the traditional high season was over and were slightly ahead of plan coming out of a successful December holiday period. Incremental advertising also helped the category remain relevant in the off season, particularly with the boost from the Superbowl in January. Sales slowed marginally in early winter; however, they finished strong in the final sales period of the fiscal year with an 11 per cent increase compared to the previous year's results.

Vintages

Vintages is the fine wines and premium spirits business unit of the LCBO. Following its vision, "Discover our Latest," in 2006-07 Vintages released 4,530 products into the market through a variety of programs, including Retail releases, Classics Catalogue, Bordeaux Futures, direct marketing and special events. Favourable foreign exchange rates helped moderate fine wine prices during 2006-07. Customers continue to demand value across all price points and are trading up to premium and ultra-premium products. In fiscal 2006-07, net sales of Vintages New World wines and products in the spirits category outperformed sales of the European wine category, generating $132 million and $127.6 million, respectively.

Go to www.lcbo.com/AnnualReport for the full story.

Support for Ontario Wine, Spirits and Craft Beer

The LCBO is a strong and proud supporter of Ontario wines, spirits and craft beers and uses displays, promotions, special events and employee development programs to keep local producers in the spotlight.

Some of the ways the LCBO supported Ontario products in 2006-07 were:

- *Buy to Fly*, a four-week promotion of Ontario wines that increased sales by 13.6 per cent over the same period the previous year. This brought year-to-date Ontario wine sales to 7.4 per cent over the previous year, including a 13.3 per cent increase in sales through VINTAGES and an increase of 7.3 per cent in VQA sales.
- Working with Ontario Craft Brewers, the LCBO sold 2.6 million bottles of Ontario craft beer. This represented net sales of $4.5 million, up 27.6 per cent over the previous year. Promotions included information on the Craft Beer Route to encourage visits to craft breweries across Ontario.
- A promotion called *Whisky Generation* was the most extensive and successful spirits promotion to date. It boosted sales 9.3 per cent over the same time the previous year, including a 6.4 per cent increase in Canadian whisky – a big jump over a year-to-date trend of 1.2 per cent in sales of Canadian whisky.

Financial Overview

The LCBO posted its highest net income ever in 2006-07, totalling $1.3 billion and representing a $96.3-million increase over the previous year.

The LCBO generated a record $3.895 billion in net sales in 2006-07. Net income as a percentage of net sales improved to 33.4 per cent from 32.9 per cent a year earlier and exceeded plan by 0.5 per cent due to enhanced margins.

The LCBO transferred a record $1.28-billion dividend to the provincial government in 2006-07, excluding all taxes. This was an $80-million increase over the previous year. It was the 13th straight year the LCBO increased its dividend to government, the 12th straight record year and the fourth consecutive dividend of more than $1 billion. The LCBO dividend does not include Provincial Sales Tax, which amounted to $363 million in 2006-07.

Sales growth of 6.4 per cent in fiscal 2006-07 was stronger than the four per cent growth rate for total retail sector sales in Ontario during the same period.

The 2007-08 fiscal year is expected to see continued growth, with net sales forecast to top $4 billion and the dividend projected to rise to $1.325 billion, an increase of $45 million.

Responsibility for Financial Reporting

The accompanying financial statements of the Liquor Control Board of Ontario have been prepared in accordance with accounting principles generally accepted in Canada, and are the responsibility of management. The preparation of financial statements necessarily involves the use of estimates based on management's judgment, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to June 13, 2007.

Management is responsible for the integrity of the financial statements and maintains a system of internal controls designed to provide reasonable assurance that the assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for appropriate delegation of authority and segregation of responsibilities. An internal audit function independently evaluates the effectiveness of these internal controls on an ongoing basis and reports its findings to management and the audit and governance review committee of the board.

The Board, through the audit and governance review committee, is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The audit and governance review committee, comprised of three members who are not employees/officers of the LCBO, generally meets periodically with management, the internal auditors and the Office of the Auditor General to satisfy itself that each group has properly discharged its respective responsibility.

The financial statements have been audited by the Office of the Auditor General. The auditor's responsibility is to express an opinion on whether the financial statements are fairly presented in accordance with generally accepted accounting principles. The auditor's report outlines the scope of the auditor's examination and opinion.

Bob Peter

N. Robert Peter
President and Chief Executive Officer

J. C. Browning

J. Alex Browning
Senior Vice President,
Finance and Administration,
and Chief Financial Officer
June 13, 2007

Auditor's Report

To the Liquor Control Board of Ontario and to the Minister of Public Infrastructure Renewal

I have audited the balance sheet of the Liquor Control Board of Ontario as at March 31, 2007 and the statements of income and retained income and cash flows for the year then ended. These financial statements are the responsibility of the Board's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Board as at March 31, 2007 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Ontario
June 13, 2007

Jim McCarter, CA
Auditor General
Licensed Public Accountant

Balance Sheet

As at March 31, 2007

	2007 ($ 000)	2006 ($ 000)
ASSETS		
CURRENT		
CASH AND CASH EQUIVALENTS	135,785	108,530
ACCOUNTS RECEIVABLE, TRADE AND OTHERS	24,042	20,520
INVENTORIES	320,675	285,817
PREPAID EXPENSES	20,017	13,038
	500,519	427,905
LONG-TERM		
CAPITAL ASSETS *(NOTE 5)*	233,073	228,702
	733,592	656,607
LIABILITIES AND RETAINED INCOME		
CURRENT		
ACCOUNTS PAYABLE AND ACCRUED LIABILITIES	361,785	320,193
CURRENT PORTION OF ACCRUED BENEFIT OBLIGATION *(NOTE 3)*	11,943	5,323
	373,728	325,516
LONG-TERM		
ACCRUED BENEFIT OBLIGATION *(NOTE 3)*	48,983	41,111
RETAINED INCOME	310,881	289,980
	733,592	656,607

Commitments and contingencies *(notes 6 and 8)*

See accompanying notes to financial statements.

Approved by:

Chair

* Board Member, Chair
Audit Committee

* In May, 2007, the LCBO Board unanimously agreed to split the Audit and Governance Review Committee into two new Board committees in keeping with other measures designed to improve corporate governance: the Audit Committee and the Governance and Compensation Committee. During fiscal 2006-07, Laurel Murray was a member of the Audit and Governance Review Committee, but when these two new committees were formed she was elected chair of the Audit Committee, hence why she signed the Financial Statements in this new role. Jean Simpson, the former Chair of the Audit and Governance Review Committee, was elected Chair of the Governance and Compensation Committee.

Statement of Income and Retained Income

Year Ended March 31, 2007

	2007 ($ 000)	2006 ($ 000)
SALES AND OTHER INCOME	3,922,648	3,682,919
COST AND EXPENSES		
COST OF SALES	1,989,297	1,885,612
RETAIL STORES AND MARKETING	423,276	400,443
WAREHOUSING AND DISTRIBUTION	79,553	76,072
ADMINISTRATION	80,688	67,349
AMORTIZATION	49,233	49,099
	2,622,047	2,478,575
NET INCOME FOR THE YEAR	1,300,601	1,204,344
RETAINED INCOME, BEGINNING OF YEAR	289,980	285,636
	1,590,581	1,489,980
DEDUCT		
DIVIDEND PAID TO THE PROVINCE OF ONTARIO	1,275,000	1,195,000
PAYMENT TO MUNICIPALITIES ON BEHALF OF THE PROVINCE OF ONTARIO *(NOTE 9)*	4,700	5,000
	1,279,700	1,200,000
RETAINED INCOME, END OF YEAR	310,881	289,980

See accompanying notes to financial statements.

Statement of Cash Flows
Year Ended March 31, 2007

	2007 ($ 000)	2006 ($ 000)
CASH PROVIDED FROM OPERATIONS		
NET INCOME	1,300,601	1,204,344
AMORTIZATION	49,233	49,099
LOSS (GAIN) ON SALE OF CAPITAL ASSETS	(2,060)	339
	1,347,774	1,253,782
NET CHANGE IN NON-CASH ITEMS		
WORKING CAPITAL	(3,767)	(1,085)
ACCRUED BENEFIT OBLIGATION	14,492	3,991
	1,358,499	1,256,688
CASH USED FOR INVESTMENT ACTIVITIES		
PURCHASE OF CAPITAL ASSETS	(54,217)	(54,535)
PROCEEDS FROM SALE OF CAPITAL ASSETS	2,673	104
	(51,544)	(54,431)
CASH USED FOR FINANCING ACTIVITIES		
DIVIDEND PAID TO THE PROVINCE OF ONTARIO	(1,275,000)	(1,195,000)
PAYMENT TO MUNICIPALITIES ON BEHALF OF THE PROVINCE OF ONTARIO	(4,700)	(5,000)
	(1,279,700)	(1,200,000)
INCREASE IN CASH DURING THE YEAR	27,255	2,257
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	108,530	106,273
CASH AND CASH EQUIVALENTS, END OF YEAR	135,785	108,530

See accompanying notes to financial statements.

1. Nature of the Corporation

The Liquor Control Board of Ontario (Board) is a corporation without share capital incorporated under the *Liquor Control Act*, R.S.O. 1990, Chapter L.18. The corporation is a government enterprise responsible for regulating the production, importation, distribution and sale of alcoholic beverages in the Province of Ontario. As an Ontario Crown Corporation, the Board is exempt from income taxes under Section 149(1)(d) of the *Canadian Income Tax Act*. The Board transfers most of its profits to the Province of Ontario's Consolidated Revenue Fund in the form of a dividend.

2. Significant Accounting Policies

(a) Basis of Accounting

The Board's financial statements are prepared in accordance with Canadian generally accepted accounting principles.

(b) Cash and Cash Equivalents

Cash, and cash equivalents comprise cash and highly liquid investments with original maturity dates of less than 90 days.

The Board's investment policy restricts short-term investments to high liquidity, high grade money market instruments such as federal/provincial treasury bills, banker's acceptances and term deposits.

(c) Inventories

Inventories are valued at the lower of cost and net realizable value with cost being determined by the moving average cost method.

(d) Capital Assets

Major capital expenditures with a future useful life beyond the current year are capitalized at cost and are amortized on a straight-line basis according to their estimated useful lives, as follows:

BUILDINGS	→	20 YEARS
FURNITURE AND FIXTURES	→	5 YEARS
LEASEHOLD IMPROVEMENTS	→	5 YEARS OR 10 YEARS
COMPUTER EQUIPMENT	→	3 YEARS OR 4 YEARS

Minor capital expenditures and the expenditures for repairs and maintenance are charged to income.

(e) Revenue Recognition

Revenue is recognized when the sale of products is made to customers.

(f) Expense Recognition

Expenses are recognized as incurred, on an accrual basis, in the period to which they relate.

(g) Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Accrued Benefit Obligation

The accrued benefit obligation includes accruals for employee termination payments, unfunded workers' compensation obligations and unused vacation entitlements.

In fiscal 2007, the cost of these employee future benefits was $23.2 million (2006 – $10.9 million) and is included in Cost and Expenses in the Statement of Income and Retained Income. The accrued benefit obligation as at March 31, 2007 is $60.9 million (2006 – $46.4 million) of which $11.9 million (2006 – $5.3 million) is classified as a current liability.

The cost of post-retirement, non-pension employee benefits is paid by the Ministry of Government Services and is not included in the Statement of Income and Retained Income.

4. Pension Plan

The Board provides pension benefits for all its permanent employees (and to non-permanent employees who elect to participate) through the Public Service Pension Fund (PSPF) and the Ontario Public Service Employees' Union Pension Fund (OPSEU Pension Fund) which are multi-employer defined benefit pension plans established by the Province of Ontario. These plans are accounted for as defined contribution pension plans as the Board has insufficient information to apply defined benefit plan accounting. The expense represents the Board's contributions to the plans during the year.

In fiscal 2007, the expense was $15.9 million (2006 – $15.3 million) and is included in Cost and Expenses in the Statement of Income and Retained Income.

5. Capital Assets

	2007 ($ 000)			2006 ($ 000)
	COST	ACCUMULATED AMORTIZATION	NET BOOK VALUE	NET BOOK VALUE
LAND	13,139	—	13,139	13,223
BUILDINGS	332,611	230,643	101,968	103,669
FURNITURE AND FIXTURES	82,266	51,408	30,858	33,397
LEASEHOLD IMPROVEMENTS	231,400	172,668	58,732	54,431
COMPUTER EQUIPMENT	102,609	74,233	28,376	23,982
	762,025	**528,952**	**233,073**	**228,702**

6. Lease Commitments

The Board is committed under operating leases on leased premises with future minimum rental payments due as follows:

		($ 000)
2008	→	41,862
2009	→	40,896
2010	→	36,984
2011	→	34,673
2012	→	31,248
THEREAFTER	→	240,071
TOTAL	→	**425,734**

7. Financial Instruments

The Board's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities. The carrying values of these instruments approximate fair value due to the short-term maturities of these instruments.

In management's opinion, the Board is not exposed to significant interest, foreign exchange or credit risks arising from these financial instruments. To manage foreign exchange risk associated with its purchases from foreign suppliers, the Board is authorized to enter into foreign exchange forward contracts, which are commitments to purchase foreign currencies at a specified date in the future at a fixed rate. As at March 31, 2007,

the Board had no (2006 – nil) foreign exchange forward contracts outstanding.

Credit risk is the risk that a party to a foreign exchange forward contract will fail to discharge its obligation and cause the Board to incur financial loss. The Board minimizes credit risks by only dealing with major Canadian chartered banks and Canadian subsidiaries of major foreign banks.

8. Contingencies

The Board is involved in various legal actions arising out of the ordinary course and conduct of business. The outcome and ultimate disposition of these actions are not determinable at this time. Accordingly, no provision for these actions is reflected in the financial statements. Settlements, if any, concerning these contingencies will be accounted for in the period in which the settlement occurs.

9. Payment To Municipalities

Consistent with prior years, in fiscal 2007 the Board was directed by the Government to contribute $4.7 million (2006 - $5 million) to assist municipalities with their glass-recycling costs. For each of fiscal 2008 and 2009, the Board has been directed by the Government to continue making a contribution of $5 million.

10. Ontario Deposit Return Program

On November 6, 2006, the Government of Ontario entered into an agreement with Brewers Retail Inc. for management of a province-wide container deposit return program on wine, liquor and beer containers sold through the Board and Winery and Distillery Retail Stores. Brewers Retail Inc. was appointed the exclusive service provider for a period of five years effective February 5, 2007.

Under the program, the Board is to collect a deposit of 10 or 20 cents on wine, liquor and beer containers. The Board is to reimburse Brewers Retail Inc. for deposits that it pays to customers who return containers to return locations it operates, plus a service fee. In addition, the Government has directed the Board to spend $7.5 million over the first two years of the agreement to promote the program.

For the year ended March 31, 2007, the Board collected $6.3 million of deposits on containers and was invoiced $3.8 million by Brewers Retail Inc. for refunds to the customers.

Expenditures in connection with this program for the year ended March 31, 2007 amounted to $2.5 million for service fees to Brewers Retail Inc. and $5.8 million for promoting the program. These expenditures are included in Administration in the Statement of Income and Retained Income.

DESIGN: COMPASS360 DESIGN & ADVERTISING ILLUSTRATION: TIM ZELTNER (I2I ART)

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